

their business plans. This evidence indicates that carriers are deploying advanced services to the business market initially as well as the residential and small business markets.”¹⁰⁷ Such marketplace evidence has grown stronger over time. Since the *UNE Remand Order*, the number of installed CLEC packet switches has essentially doubled to 1700, and the average number of packet switches per MSA has grown by approximately 150 percent in the top 100 MSAs.¹⁰⁸ Indeed, the largest providers of frame relay and ATM services are AT&T, WorldCom, and Sprint, rather than any of the ILECs.¹⁰⁹

Moreover, the ILECs have no scale advantages when they roll out these new networks. According to the Commission’s latest estimates, cable modem providers have approximately 64 percent of the residential and small business broadband market,¹¹⁰ while DSL providers in the aggregate have a share of approximately 34 percent.¹¹¹ Nor is there any evidence that DSL will gain a dominant market share in the foreseeable future, as the Commission itself has noted.¹¹² Indeed, analysts have predicted that by year-end 2002, cable modem providers will, in the

¹⁰⁷ *Id.* ¶ 307.

¹⁰⁸ *UNE Fact Report* at II-23 to II-24.

¹⁰⁹ *Id.* at II-24; see also Comments of Qwest Communications International Inc., *Review of Regulatory Requirements for Incumbent LEC Broadband Telecommunications Services*, CC Docket No. 01-337, at 4 (filed Mar. 1, 2002).

¹¹⁰ Third Report, *Inquiry Concerning the Deployment of Advanced Telecommunications Capability to All Americans in a Reasonable and Timely Fashion, and Possible Steps to Accelerate Such Deployment Pursuant to Section 706 of the Telecommunications Act of 1996*, CC Docket No. 98-146, FCC 02-33, App. C, Table 3 (rel. Feb. 6, 2002) (“*Third Advanced Services Report*”).

¹¹¹ *Id.* The aggregate share for ILEC DSL services is even less, as the 34 percent share is for all providers of DSL and includes “other wireline” services, which are not all DSL services. Wireless and satellite providers held approximately 2 percent combined. *Id.*

¹¹² See *id.* ¶ 63.

aggregate, have approximately 9.6 million subscribers, while DSL providers will have fewer than 6 million.^{113/} In view of the Commission's ruling that cable modem service is not a telecommunications service and therefore not subject to section 251 unbundling requirements, imposing such requirements, and the resulting costs, on DSL facilities would only handicap DSL's ability to compete with cable modem service. Such an outcome is unjustifiable in view of the relative market shares of the two services.

Thus, the impairment analysis for advanced services facilities starts from a much different place than the Commission's analysis of other network elements, where it was sometimes presumed that unbundling was necessary to eliminate any advantages based on ILECs' economies of scale. In short, incumbents do not possess significant economies of scale when they deploy advanced services facilities.^{114/}

2. Line Sharing and Fiber Deployment

The Commission also should not expand line sharing requirements, especially to fiber. Line sharing has been a failed experiment. Qwest has spent large sums to allow for unbundled access to the high frequency portion of the loop as required by the Commission, but to date has been able to recover only a fraction of those expenditures because of low CLEC demand, as well as the way in which TELRIC has been applied in this context. Qwest spent approximately \$12.3 million for network and OSS changes, but fewer than .05% of its network access lines are currently being shared. Although Qwest does not oppose grandfathering current locations where

¹¹³ Yankee Group, Cable Modem Providers Continue to Lead the High-Speed Internet Charge: The Yankee Group's Predictions on Consumer Broadband Services (August 2001); Yankee Group, Broadband Access Technology: Whose Number is Up? (September 2001).

¹¹⁴ See *UNE Remand Order* ¶ 308 ("It . . . does not appear that incumbent LECs possess significant economies of scale in their packet switches compared to the requesting carriers.")

it has already deployed line sharing capability,^{115/} this requirement should not be extended to new locations or technologies. The fact that CLECs have rarely used this capability alone demonstrates that they would not be impaired without access to it.

Moreover, the availability of dark fiber loops (as well as subloop unbundling) provides CLECs an alternative means of providing advanced services. New architectures that involve extending the reach of fiber “to the curb” or even “to the home” can take at least three forms — “overlay” facilities that supplement existing facilities, “replacement” facilities that completely replace existing facilities, and new construction/greenfield builds in an area that was not previously served.^{116/} In the case of overlay facilities, which are more common than replacement facilities, the construction of the new facilities does not in itself alter a CLEC’s ability to provide services using the preexisting network. CLECs could continue to provide POTS, DSL, or any other telecommunications service via unbundled copper loops in the same manner they provided these services prior to the construction of the new network. Likewise, a CLEC could continue to provide its chosen services through line sharing over copper loops or by obtaining a copper subloop in the preexisting network architecture. Thus, lack of unbundled access to a new overlay network would not raise competing carriers’ entry costs or otherwise diminish their ability to provide the services they seek to provide.

Reasonable transitional arrangements could be required to maintain the availability of copper loops in the case of overlay deployments. Qwest does not proactively remove copper facilities in the case of an overlay. The placement of fiber rarely *accelerates* the retirement of

¹¹⁵ This assumes, of course, that the D.C. Circuit Court of Appeals upholds the Commission’s *Line Sharing Order* on appeal.

¹¹⁶ Notice ¶ 50.

copper facilities. Thus, existing services or products being purchased by a CLEC should not as a factual matter be jeopardized by a change in technology.

In the case of replacement or new construction/greenfield builds, a CLEC would have a variety of options. To the extent a CLEC wants to provide voice service, Qwest could hand off a voice grade circuit at the central office to the CLEC. A CLEC wishing to provide advanced services could purchase dark fiber to the central office (at UNE rates) and simply add its own electronics to light the fiber; as the Commission found with respect to DSLAMs, CLECs are not impaired without access to ILEC electronics. In addition, to the extent that the loop in question contained any copper (e.g., from the “curb” to the home), Qwest would unbundle that subloop. Thus, by leasing dark fiber loops or subloops from the ILEC and providing its own electronics, the CLEC could effectively duplicate the ILEC’s ability to provide advanced and broadband services over a fiber (or primarily fiber) loop.

Of course, carriers could also choose to self-provision facilities to provide broadband and other telecommunications services, especially in new construction/greenfield builds because the CLEC can build at the same time as the ILEC. That is exactly what the ILECs’ cable, wireless, and satellite competitors have done.

B. Requiring Unbundled Access to Advanced Services Facilities Would Deter Facilities-Based Competition for Broadband Services and Deployment of Broadband Facilities.

When the Commission declined to unbundle packet switching, except in limited circumstances, in the *UNE Remand Order* it said it did so in order not to “stifle burgeoning competition in the advanced services market.”¹¹⁷ The Commission further recognized that “regulatory restraint” was prudent to further the Act’s goal of encouraging facilities-based

¹¹⁷ *UNE Remand Order* ¶ 316.

investment and innovation.^{118/} That logic is just as valid today as it was three years ago.

Imposing unbundling obligations on the ILECs' advanced services will deter such deployment and undermine the ability of Qwest and other ILECs to raise capital for new infrastructure.^{119/}

It is critical that such broadband deployment occur now. The construction of broadband networks in general is a fundamental national interest. Moreover, it is particularly important for Qwest and other ILECs to undertake such deployment, given the limitations of the existing telephone network and the need to promote effective competition to cable modem providers. Today, ILECs provide broadband services to residential and small business customers primarily through DSL services. While these services can provide broadband access to many telephone customers, distance limitations and other technical constraints of DSL prevent it from being available to all customers without major upgrades to existing telephone plant. According to Commission statistics, as of June 2001, seventy percent or more of U.S. households could obtain cable modem service,^{120/} but DSL services were available to only 45 percent of customers.^{121/} In Qwest's territory DSL is available to only 36 percent of residences and businesses. Massive investment is needed to overcome these current limitations and substantially increase the availability of broadband services to potential customers. Qwest and other incumbents will

¹¹⁸ *Id.*

¹¹⁹ See Haring & Shooshan at 9 ("If a competitor is compelled to share (prematurely or unremuneratively) the fruits of its efforts to advance technology and produce better products and service capabilities, its ability to appropriate economic rewards from such efforts and, hence, its economic incentives to undertake such efforts will be attenuated with adverse consequences for the vigor of competition and the dynamism of the competitive process.")

¹²⁰ *Third Advanced Services Report* ¶¶ 46, 51.

¹²¹ *Id.* ¶ 51. Notably, satellite service is available virtually anywhere in the United States. See *UNE Fact Report* at IV-22.

undertake such investment, however, only to the extent the attendant risks are outweighed by the expected return.

By their nature, investments in facilities to provide broadband services are more risky than investments in well-established markets.^{122/} These risks are of various types. On the whole, demand for broadband services is very uncertain. Today, only about 10 percent of customers who can get broadband services actually take it. Some have theorized that the take-rate for broadband services will increase with the development of a so-called “killer app,”^{123/} but no one knows if that is true or, if so, when that will occur.^{124/} In addition, given steady competition from cable modem providers, and growing competition from satellite and fixed wireless providers, demand for DSL services in particular is uncertain. Finally, the rapid evolution of broadband technologies creates a risk that an incumbent deploying a new network will not be able to recover its investment due to technical obsolescence. Such obsolescence could be caused either by newer cheaper technologies that allow other carriers to undercut the price of services based on the ILEC’s deployed technology, or by technologies that are functionally superior, such as ones that provide higher bandwidth. Indeed, DSL has been referred to as a “transitional” technology, in part because (at least today) it generally is not capable of the bandwidth that many believe will eventually be demanded by broadband users. As fiber is extended closer to end

¹²² *UNE Remand Order* ¶ 314.

¹²³ *UNE Fact Report* at V-25 to V-26.

¹²⁴ On the other hand, higher demand for broadband in other countries provides hope for a similar trend in the U.S. See generally Third Report, *Inquiry Concerning the Deployment of Advanced Telecommunications Capability to All Americans in a Reasonable And Timely Fashion, and Possible Steps To Accelerate Such Deployment Pursuant to Section 706 of the Telecommunications Act of 1996*, CC Docket No. 98-146, FCC 02-33, ¶¶ 127-29 (rel. Feb. 6, 2002).

users, current technologies will likely be supplanted by more advanced technologies that carry higher bandwidths. All indications are that such additional capacity will be necessary for routine use of many broadband applications.^{125/}

The application of unbundling requirements to these new deployments would further increase the risks associated with these investments by adding significant additional costs that likely cannot be recovered. In this context, unbundling obligations would increase operating costs, require network changes to allow for unbundling (assuming it is technically feasible), and entail expensive operations support system upgrades that would otherwise not be necessary.

There is also no guarantee that an ILEC deploying such a network architecture would be able to recover these costs. In the past, Qwest has incurred large expenses to allow unbundled access to particular network elements as required by the Commission — and as demanded by CLECs — and then subsequently found that there is scant demand from CLECs for the unbundled functionalities. For example, in deploying remote terminals, Qwest spent millions of dollars to ensure the availability of collocation in 1,481 remote collocation sites consistent with the Commission's rules,^{126/} yet, at this point in time, *only two of those remote terminal sites are being used by a CLEC*. Given these risks, Qwest and other ILECs are reluctant to invest in new broadband deployments.^{127/}

¹²⁵ See *UNE Fact Report* at IV-23, V-25 to V-26.

¹²⁶ Qwest spent approximately \$3400 per terminal to enlarge cabinets and resolve security and access concerns.

¹²⁷ See Letter from Thomas Tauke, Verizon, to Chairman Powell at 4 (filed Nov. 7, 2001 in CC Docket No. 96-98) (“The resulting uncertainty [over unbundling of line cards in remote terminals] is one of the key reasons that Verizon to this point has significantly constrained deployment of DSL capability in our remote terminals.”).

Further aggravating the situation, a CLEC will have no reason to invest in facilities related to new services if it knows that it will have the right to obtain the requisite facilities at TELRIC rates from the incumbent: the CLEC can avoid the investment risks, while being assured that it will not suffer a competitive disadvantage vis-à-vis the incumbent since it can always utilize the incumbent's facilities if demand materializes.

Thus, it is essential that the Commission exhibit "regulatory restraint" with regard to unbundling requirements for advanced services. Such restraint is appropriate because the lack of unbundling obligations in this instance will not materially diminish CLECs' ability to provide the services they seek to offer. Moreover, even if CLECs were so impaired, such concerns are clearly outweighed by the need to encourage the deployment of broadband facilities.

IV. THE COMMISSION SHOULD ACT PROMPTLY, AND NOT AWAIT THE CONCLUSION OF THIS DOCKET, TO CORRECT FUNDAMENTAL VIOLATIONS OF TELRIC THAT REMOVE INCENTIVES FOR CLECS TO INVEST IN ALTERNATIVE FACILITIES.

In their initial discussion of this proceeding, members of the Commission indicated that this *Triennial Review* would consider both which elements should be subject to unbundling and whether and how TELRIC pricing should continue to apply to such elements.^{128/} As Chairman Powell and Commissioner Martin recognized, it makes eminent sense to consider all of these unbundling issues together because they are so closely interrelated.^{129/} The effect of unbundling

¹²⁸ See Michael K. Powell, Digital Broadband Migration: Part II, Press Conference (Oct. 23, 2001) (noting that the *Triennial Review* would "be the principal docket for evaluating unbundled network policy, including access, ordering *and pricing*") (emphasis added).

¹²⁹ See Michael K. Powell, Remarks at the Association for Local Telecommunications Services (Nov. 30, 2001) ("Th[e] [*Triennial Review*] proceeding is designed to roll up a number of UNE issues that have been pressed upon us in piecemeal fashion. A comprehensive proceeding will allow us to examine the host of UNE related issues that have been swirling around."). Even after the *Notice* was issued, Commissioner Martin recognized the importance of examining pricing issues in connection with this proceeding:

requirements on both CLECs' and ILECs' investment incentives, for example, depends to a large extent on how the Commission's pricing rules are interpreted and applied. Thus, a comprehensive review of the unbundling rules would necessarily require an analysis of the pricing rules as well, and failure to undertake that analysis will mean that this proceeding is incomplete. Simply put, if UNE prices are not set properly, the unbundling regime will almost inevitably cause distortions in carriers' decisions as to whether to "make" or "buy" facilities and discourage the investment in facilities. As a result, the improper application of TELRIC that produces rates below forward-looking costs can be just as devastating to the prospects for facilities-based competition as deciding to require the unbundling of a UNE that is not necessary to create or maintain competition.

Qwest's experience over the past several years confirms that the need for Commission action with respect to UNE prices is at least as urgent as it is with respect to identifying and defining the elements that are subject to the unbundling requirements. Over the last several years, CLECs have urged with substantial success that the purpose of TELRIC is to develop the lowest prices possible so as to promote intramodal competition by resellers (and to the detriment of facilities-based competition and competitors). To achieve that end, they have distorted the most basic TELRIC principles to justify the use of cost models and inputs that bear no relationship to the TELRIC methodology as originally formulated by the Commission. CLECs

[W]e ought to reexamine how our unbundling and/or pricing rules apply to incumbent deployment of new facilities. For example, once we have determined that a particular state's market "is fully and irreversibly open to competition," how is access to yet-unbuilt new facilities at super-efficient prices necessary to enable a new entrant to compete? — especially if existing facilities or their equivalent capacity are maintained at current prices. I look forward to examining these issues in our triennial review proceeding.

Kevin J. Martin, Remarks to the Federal Communications Bar Association (Feb. 1, 2002).

have been assisted in this endeavor by certain decisions by the Commission in other proceedings, notwithstanding the Commission's caution that these decisions do not apply to the determination of UNE prices. The Commission should therefore act promptly to (1) reiterate that the purpose of TELRIC is not to establish the lowest possible prices for resellers, but to send to new entrants the correct economic signals whether to build their own facilities or lease them from ILECs;¹³⁰ (2) correct some of the more fundamental misapplications of TELRIC that CLECs have been urging in the states; and (3) clarify that certain decisions with respect to the cost model used to calculate the allocation of universal service support are not to be applied to determine UNE prices.

The Commission has explained that the "essential objective" of TELRIC "is to determine what it would cost, in today's market, to replace the functions of [a network] asset that make it useful," while simultaneously taking as given "the most basic geographical design of the existing network."^{131/} By attempting to "replicat[e] . . . the conditions of a competitive market," TELRIC is intended to give CLECs appropriate price signals about when it would be efficient, and when inefficient, to build their own facilities rather than leasing elements from the incumbent.^{132/} Such price signals can be accurate only if UNE prices reflect an accurate measure of forward-looking costs. Prices that are less than forward-looking costs inevitably create incentives for CLECs to rely on UNEs in at least some cases where it would be more economically efficient for them to invest in their own facilities; thus, below-cost prices inevitably slow, and in some cases prevent,

¹³⁰ See Haring & Shooshan at 25-26, 33.

¹³¹ Brief for Petitioners FCC and United States, *Verizon Communications Inc. v. FCC*, No. 00-511 and consolidated cases, at 6, 9 (U.S. April 2001) (emphasis added).

¹³² *Local Competition Order* ¶ 679; see also *id.* ¶¶ 620, 683-85.

the development of facilities-based competition. Moreover, incumbents have significantly less incentive to invest in new facilities and take on the risks associated with substantial (and often sunk) investment in facilities to the extent that they have to turn around and share those facilities with their competitors at prices at or below cost, especially when state commissions, as they often do, fail to account for the relevant competitive and regulatory risks in determining the cost of capital.

Even when TELRIC is properly and reasonably applied, the continued disconnect between retail prices and costs skews competitive entry decisions of CLECs and creates opportunities for regulatory arbitrage.^{133/} For example, since retail rates for business customers are usually well above cost, CLECs that want to serve such customers without deploying their own facilities have every reason to use the ostensibly cost-based UNE-P rather than resale. And of course the incentives are reversed in the case of residential customers whose retail rates tend to be below cost.

Perhaps more significantly, the implicit subsidies that are inherent in ILECs' regulated rate structure create significant pressures on state commissions to distort TELRIC in an effort to prime the pump for economically inefficient UNE-based competition.^{134/} CLECs insist to state commissions interested in at least the appearance of residential competition that, in view of the below-cost retail residential rates, the only way to make it "sufficiently profitable" for CLECs to serve residential customers is to lower UNE rates dramatically. But lowering UNE rates so as to permit CLECs to "match" ILECs' below-cost residential rates necessarily requires distorting

¹³³ See Haring & Shooshan at 27-31, 33-34.

¹³⁴ See *id.* at 27-31.

TELRIC so that it no longer even comes close to “represent[ing] the incremental costs that incumbents actually expect to incur in making network elements available to new entrants.”^{135/}

One form of such distortion occurs when states mix and match historical and forward-looking inputs based on which input happens to produce the lower cost. For example, when determining the percentage of structure sharing to assume in costing out a replacement network, state commissions have looked to, not how much it would cost an efficient carrier to build a replacement network *today* as TELRIC requires, but how much it would have cost that carrier to build a replacement network *many years ago*, before present-day buildings and other obstructions were built in developed areas and before other utilities had already deployed most of their own facilities.^{136/} As a result, states have assumed much greater structure sharing (and therefore lower costs) than would occur today, when utilities already have placed their cables along the majority of routes a new entrant would build. Similarly, in an effort to lower UNE rates, some states have disregarded the costs of the more expensive cable placement methods and restoration required when placing cable in already-developed areas (as opposed to placing cable before buildings and roads have been built),^{137/} even though a carrier reconstructing the network clearly would have to bear those costs today and in the future. Decisions such as these directly

¹³⁵ *Local Competition Order* ¶ 685.

¹³⁶ See, e.g., Phase II Opinion and Order, *Investigation into Qwest Corporation's Compliance with Certain Wholesale Pricing Requirements for Unbundled Network Elements and Resale Discounts*, Docket No. T-00000A-00-0194, at 12-14 (Ariz. Corp. Comm'n 2002) (“Phase II Opinion and Order”).

¹³⁷ See, e.g., *id.* at 11-12.

contradict TELRIC's requirement to calculate the costs an efficient carrier would incur to build a replacement network *today*.^{138/}

A number of state commissions have also applied this Commission's *Inputs Order* in the universal service docket as a means of determining UNE prices, ignoring the Commission's warnings against doing so. The Commission has emphasized that its Synthesis Model modeling assumptions for universal service purposes "may not be appropriate to use" in "determining prices for unbundled network elements," and it has specifically "caution[ed] parties from making any claims in other proceedings based upon the input values we adopt" in the universal service setting.^{139/} That is because, among other considerations, the objective of the *Inputs Order* was simply to determine *relative* differences in costs among states for purposes of determining which states receive federal universal service funding; the quite different objective of a UNE rate proceeding is to determine the *absolute* cost of replacing network elements. In fact, as the Commission itself has observed, any given error in its universal service cost model — even a significant one — may well have no material effect on the output of that model, because the same error, applied to different states, may largely cancel itself out in the course of the comparative analysis.^{140/} In contrast, the same error, used within a different model designed to

¹³⁸ *Id.* at 6. *Local Competition Order* ¶ 683 (stated goal of TELRIC is to "consider the costs that a carrier would incur *in the future*") (emphasis added); *id.* ¶ 685 (TELRIC costs are to be based on a "reconstructed local network").

¹³⁹ Tenth Order on Reconsideration, *Federal-State Joint Board on Universal Service*, 14 FCC Rcd 5983 ¶ 31 n.66, ¶ 32 ("*USF Inputs Order*"); accord *New York 271 Order* ¶ 245.

¹⁴⁰ See Brief for Respondents FCC and United States, *GTE Serv. Corp. et al. v. FCC*, No. 99-1244, at 27 (filed Oct. 4, 2000), *petition for certiorari dismissed*, 531 U.S. 975 (2000); see generally Ninth Report and Order and Eighteenth Order on Reconsideration, *Federal-State Joint Board on Universal Service*, 14 FCC Rcd 20432 (1999), *rev'd sub nom. Qwest Corp. v. FCC*, 258 F.3d 1191 (10th Cir. 2001).

set individual UNE rates based on *absolute* forward-looking costs, may have enormous consequences.

Nevertheless, CLECs have argued that the assumptions in the *Inputs Order* are directly applicable in state cost proceedings. For example, in a recent proceeding in Arizona, CLECs argued that the interpretation of TELRIC assumptions in the *Inputs Order* provided “ample basis” for the assumptions in a recommended decision by the state commission. The CLECs contended that the state commission should disregard Qwest’s argument that “inputs used by the FCC in its model for calculating costs for universal service purposes may not be appropriate in other contexts,” because the purpose of the universal service proceeding was to determine the forward-looking costs of constructing a wireline local telephone network.¹⁴¹ The Commission needs to reiterate in clear terms that the Synthesis Model inputs adopted for universal services purposes may not be used to set UNE prices.

The Commission will not be able to ensure that its unbundling rules provide the appropriate incentives for both CLECs and ILECs and promote the goals of the 1996 Act, as the Commission is attempting to do in this proceeding, unless the Commission addresses these types of misapplication of UNE pricing rules by state commissions. Unfortunately, the only context in which the Commission currently addresses TELRIC pricing is in reviewing section 271 applications, a context in which the Commission’s purpose is limited to identifying UNE rates that exceed the reasonable range that would be produced by the proper application of TELRIC. Obviously, this process is not designed to identify and correct UNE prices that have been set too

¹⁴¹ Response of AT&T and XO to Qwest’s Exceptions, *Investigation into U S West Communications, Inc.’s Compliance With Certain Wholesale Pricing Requirements for Unbundled Network Elements and Resale Discounts*, Docket No. T-00000A-00-0194, at 8 (Ariz. Corp. Comm’n Feb. 1, 2002); see also *Phase II Opinion and Order* at 17 (relying on USF Inputs Order in determining fill factors).

low due to misapplications of TELRIC. Thus, the section 271 process tends to act as a one-way, downward ratchet for TELRIC rates, and the Commission does not have a countervailing procedure to consider and correct TELRIC rates that are unreasonably low. The Commission should therefore, in this or a simultaneous proceeding, address the misapplications of TELRIC described above.

The Commission's "benchmarking" analysis in its Section 271 decisions, though well-intentioned, can exacerbate the trend toward "below TELRIC" rates. When reviewing an ILEC's UNE rates, the Commission requires the ILEC to show either that the state commission "correctly applied TELRIC principles in all instances" or that the resulting UNE rates are not higher than those in a state whose UNE rates were determined to be fully TELRIC-compliant in a section 271 proceeding.^{142/} To date, the Commission has allowed the UNE rates from only a handful of states to be used as benchmarks. In recent section 271 orders, the Commission has found the state commission's application of TELRIC to be deficient in some way and then turned to its benchmark analysis to evaluate UNE rates in that state.^{143/} In its benchmarking analysis, the Commission considers loop rates separately from non-loop rates and focuses its attention on any UNE rate that is higher than in the benchmark state, even if the other UNE rates are lower than in the benchmark state (and lower than even a reasonable application of TELRIC would produce).

¹⁴² See *Rhode Island 271 Order* ¶¶ 32, 37-38.

¹⁴³ In the *Pennsylvania 271* proceeding, the Commission found "that the Pennsylvania Commission generally followed basic TELRIC principles" but also relied on its benchmarking analysis to conclude that Verizon's UNE rates were TELRIC-compliant. *Pennsylvania 271 Order* ¶¶ 55-72.

This type of benchmarking analysis can be problematic in at least two ways. First, though the Commission adopted the benchmarking analysis as a way to preserve state commissions' discretion to set UNE prices within a reasonable TELRIC range (particularly where the state commission has made inconsequential errors in the application of TELRIC), benchmarking can have the opposite effect. Increasing reliance on benchmarking can preclude the adoption of UNE rates that exceed the rates in the benchmarking states but still fall within a reasonable TELRIC range. Second, there is no particular reason to believe that the UNE rates in the three current benchmark states are anywhere near the mid-point (much less the upper limit) of TELRIC reasonableness. Indeed, the UNE rates in these states may well be set below TELRIC, because ILECs do not use section 271 proceedings as forums to complain about low rates.^{144/} Thus, the benchmarking process can only be expected to push rates down to noncompensatory levels.

Whether or not the Commission takes this opportunity to help avoid the methodological errors that produce below-cost UNE rates, the Commission at the very least must be conscious of the effects of its pricing rules, and states' application of those rules, in analyzing what elements should be subject to unbundling requirements in this proceeding. For example, the Commission should not conclude that, merely because CLECs have not yet deployed significant quantities of a particular network element, but instead are relying on the ILECs' UNE facilities, some barrier to deployment of that element must exist. While evidence of such deployment should be conclusive, the converse is not the case, specifically because of the distortions caused by some

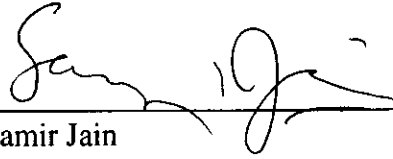
¹⁴⁴ Not surprisingly, CLECs have urged the Commission to select benchmarking states with the lowest possible UNE rates. See, e.g., *Massachusetts 271 Order* ¶ 28 & n.69 (noting that AT&T urged the Commission not to use New York as a benchmarking state because New York's UNE rates were higher than those in Texas, Kansas, and Oklahoma).

applications of TELRIC pricing. If CLECs can lease an element from an incumbent at dramatically understated rates (as is often the case under current interconnection agreements), those understated rates may well be dictating CLECs' choices, not other barriers such as scale economies, delays, or other impairments. Similarly, an ILEC that knows it might have to unbundle new advanced facilities to competitors below (or even at) cost will have a significant disincentive to take the risk associated with such new investment. Thus, failing to exempt such facilities from unbundling will dampen investment and deployment by ILECs.

V. CONCLUSION

Marketplace evidence unequivocally demonstrates that, since the *UNE Remand Order*, CLECs have increasingly relied on self-provisioned or other non-ILEC facilities to provide local exchange service, and intermodal competition has rapidly developed to provide alternatives to ILECs' facilities and services. This evidence alone establishes that the unbundling obligations for circuit switching should be removed on a nationwide basis and for dedicated transport in markets that meet this Commission's pricing flexibility test. Moreover, particularly in view of the strong policy in favor of encouraging deployment of broadband facilities, the Commission should reaffirm and extend its decision not to require ILECs to unbundle facilities used to provide DSL and other advanced services. Finally, although the *Notice* does not mention the UNE pricing rules, the Commission must provide immediate guidance as to the interpretation of TELRIC so as to prevent further misapplications of TELRIC at the behest of CLECs and thereby permit the development of efficient facilities-based competition.

Respectfully submitted,



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April 5, 2002

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CERTIFICATE OF SERVICE

I, Carole Walsh, do hereby certify that on this 5th day of April, 2002, I have caused true and correct copies of the foregoing Comments of Qwest Communications International, Inc. to be served by hand delivery upon the following parties:

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Federal Communications Commission
445 12th Street, S.W., Room 8-201
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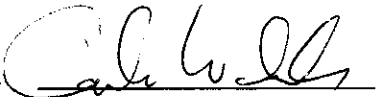
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Attachment A

REORIENTING REGULATION: TOWARD A MORE FACILITIES-FRIENDLY LOCAL COMPETITION POLICY

JOHN HARING & HARRY M. SHOOSHAN*

APRIL 3, 2002

EXECUTIVE SUMMARY

In this paper, we advocate the FCC's using the occasion of this Triennial Review to reassess not only its unbundling regime, but also its overall local competition policy. We believe the FCC should, *inter alia*, reduce the number of unbundled network elements, especially by eliminating switching and inter-office transport from the list of required "UNEs." We urge the Commission and the States to take a number of other steps to foster efficient, *facilities-based* local competition.

In contrast to other regulatory jurisdictions, notably the United Kingdom (U.K.), where "facilities-based" competition has been the main policy objective, to date the primary focus of regulatory policy to promote local telecommunications competition in the United States has been to facilitate resale and repackaging of the incumbent local exchange telephone companies' (ILECs') services and facilities. The U.K. competitive regime supplies an interesting contrast and comparison to the U.S. regime: The U.K. has put significantly greater emphasis upon promotion of facilities-based competition. As a result, the U.K. authorities have taken considerable care to avoid undermining investment in competitive facilities deployment. They have thus limited resale discounts and unbundling requirements, and have set controls for interconnection charges specifically with a view toward effects on competition. The results—especially when viewed against progress to date in the U.S.—are quite striking. Over 50 percent

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of U.K. households now have a choice of *facilities-based wireline* carriers. At the end of 2001, BT accounted for some 81.3 percent of all residential lines with NTL and Telewest accounting for nearly all the rest. However, the latter accounted for nearly 36 percent of the actual number of residential calls connected.

Unbundling is frequently touted as a useful policy for enabling a *facilities-based* local competitor to fill out holes in its service and is, in this sense, a complement to facilities-based competition. The problem is that unbundled elements are a *substitute* as well as a complement for facilities-based competition. Making the complement cheap makes competitive supply of the substitute more difficult. While the FCC has a mandate to permit interconnection wherever technically feasible, we believe that it must exercise its discretion prudently. This involves a balancing of competing (and, at the relevant margin, essentially conflicting) objectives.

The problem in the U.S. has not only been extreme unbundling, but also the cost standard employed to price various network elements. While the problems associated with TELRIC can most appropriately be addressed by changes to or clarifications of the TELRIC regime itself, the Commission should also take cognizance of the adverse effects of TELRIC in assessing which elements should be subject to unbundling requirements. If, for example, incumbents think they might have to unbundle new advanced facilities at or below cost, their incentive to undertake risky investments will be substantially, if not completely attenuated. Excessive unbundling dampens investment incentives on the part of *both* incumbents *and* new entrants.

Facilities-based competition entails increased investment in physical infrastructure assets, innovation, and real choices for consumers. It is also a necessary (and, unlike the alternative, a *sufficient*) predicate for *reduced* regulation. To the extent that competition is principally based on resale or repackaging, benefits will be limited (the scope for real competition being limited) and the government will continue to have a major—and likely expanding—role in regulating terms and conditions of access to ILEC offerings.

We believe that, heretofore, the Commission's agenda has been focused on producing near-term results, rather than on creating conditions to promote efficient competition and an effective competitive discovery process. The Commission's tack has failed to promote investment in efficient productive capacity, to encourage the development of innovative new technology and to provide a genuinely diverse set of service offerings to customers. Once the regulator decides to "create competition" (as opposed to creating the conditions for competition to operate), success or failure is often perceived as a matter of merely adjusting the dials (*e.g.*, lowering the price, ordering yet more intrusive unbundling). Marketplace success turns on much more than getting a favorable deal from regulators.

Since the Telecommunications Act of 1996 ("TA96") was enacted, the government has been about striving mightily to create competitors. It has done so by affording new entrants virtually every regulatory advantage they have sought, and has justified this tack as necessary to "jumpstart" competition and protect competitors during the "transition" to fully competitive (and

presumably *less* regulated) markets. This begs the questions “do we really have a coherent vision of where we want to go and what it will really take to get there?” We suggest the answer is “no” to both.

Part of the problem is that regulators have sought to eat their cake and have it too—that is, regulators have done the “easy” things first (*e.g.*, make it cheap for competitors to enter using pieces of the incumbent’s networks on extremely favorable terms that also allow them to undermine the inefficient retail pricing structure) but defer the “unpleasantness” of dealing with the contradictions inherent in that structure directly. The irony is that this pricing structure—that regulators are striving to retain for as long as they can (to avoid political “heat”)—has had a much more powerful effect on constraining competition than the availability of low-priced UNEs.

If the Commission truly desires welfare-enhancing, facilities-based competition that maximizes real customer choice and that justifies and permits deregulation, its policies must supply incentives for efficient network facilities-deployment by *both* incumbent and new competitors. It does not suffice to “talk the talk” of the importance and primacy of facilities-based competition unless the talk is buttressed by actually “walking the walk” in terms of formulation of regulatory policies that promote rather than detract from incentives to invest and build.

The unbundling criterion of the TA96 turns on the issue of whether access is necessary and lack of access impairs competition. When there are alternatives to shared use of an element readily at hand, whose exploitation is not difficult, it is hard to see how access can be intellectually coherently maintained to be “necessary.” Nor is it clear, *assuming* effectiveness of alternatives, how lack of access could “impair” competition in this circumstance.

Alternatives to ILEC “switching” and “transport” elements are, as we and others have documented, readily available and, in our view, so readily available that it is impossible to see how lack of access to ILEC-supplied “switching” and “transport” (especially in areas where the Commission’s pricing flexibility test has been met) could plausibly be maintained somehow to “impair” competition. In our view, this kind of situation is precisely one where compelling shared access dissipates investment incentives. It dissipates CLEC incentives to make their own network facilities or make use of non-ILEC facilities; it dissipates ILEC incentives to upgrade networks and develop new service capabilities (say, broadband) because it attenuates prospective rewards and discourages risk taking. To the extent that CLECs respond to this disincentive, competition will be limited to a relatively small portion of total value-added. To the extent that ILECs respond to this disincentive, the Commission will be writing-off some of the potentially largest contributors to technological advance and future productivity advance.

If the Commission is serious about fostering facilities-based competition, it needs to be much more sensitive to the issue of and need for economic incentives. That means not only taking a hard look at the issue of unbundling, both of existing and prospective new service capabilities,

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but also reconsidering the adverse consequences of existing pricing policies, both of inputs and outputs.

We applaud the Commission's having undertaken an effort in another docket to reform the current intercarrier compensation arrangements, which are certainly in dire need of reform. But reforms must obviously be implemented to produce salutary effects. Even then, reforms do not guarantee economic welfare gains if they are undertaken on a piece-meal basis or fail to reflect *failures* to proceed simultaneously along other relevant dimensions, viz., rate rebalancing.

We think the simplest and best solution to the problems of unbalanced rates is to rebalance rates. That is not easily accomplished, but the British have been able to travel a long way by taking small, incremental steps. We also think that significant progress can be made if ILECs are afforded greater flexibility to package a greater number of services (*i.e.*, including long-distance service) in bundled offerings, suitably priced to encourage customers to self-select more rebalanced alternatives.

Chairman Powell has stated that "*Facilities-based competition is the ultimate objective.*" The Commission needs to take greater care in promoting *non-facilities-based* methods of competition as "*useful interim steps*" lest it supply a seductive addiction that undermines incentives to deploy competitive facilities.

REORIENTING REGULATION: TOWARD A MORE FACILITIES-FRIENDLY LOCAL COMPETITION POLICY

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1. INTRODUCTION

Facilities-based competition is the ultimate objective. I believe that other methods of entry are *useful interim steps* to competing for local service, but Commission policy should provide incentives for competitors to ultimately offer more of their own facilities. This would decrease reliance on incumbent networks, provide the means for truly differentiated choice for consumers, and provide the nation with redundant communications infrastructure.

FCC Chairman Michael Powell 10/23/01

There is a widely shared sense that the Telecommunications Act of 1996 ("TA96") has failed to produce "enough" local telecom competition. Some of this sense of failure is, to be sure, attributable to the bursting of the stock market's speculative bubble and the unrealistic "anything goes/sky's-the-limit" philosophy that underpinned the historically unprecedented asset inflation of the late nineties and the lavish funding of ill- (and often barely-) considered business plans of many telecom start-ups. But more is at work here than the inevitable dashing of unrealistic expectations.

The perceived failure of competition is, in part, a misperception—lots of network competition (both facilities-based intramodal and intermodal) has developed, indeed, a surprisingly large amount given the way regulation has stacked the deck against it. Moreover, regulation has taken

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